

Demand for Aggressive Tax Planning¹

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1. Introduction

This research was undertaken to inform New Zealand Inland Revenue's current and future initiatives aimed at reducing Aggressive Tax Planning (ATP). An ATP scheme is generally understood to mean any scheme where the purpose or benefit of the scheme appears to be the reduction of taxable income or inflation of deductible expenditure, and the tax advantage sought is not clearly sanctioned by the tax laws. In other words, ATP involves those schemes that may follow the letter of the law but not its spirit (Nash & Pross, 2009).

ATP is a global phenomenon of huge importance to tax administrations. A handful of the largest ATP transactions can result in hundreds of millions of dollars in lost tax revenue. ATP can also be used to artificially increase financial entitlements, and to reduce income-related liabilities, such as accident insurance levies, child support payments, and student loan repayments.

A worrying consequence of ATP is its effect on the public's trust in the tax system. In particular, ATP creates the public perception that many 'rich' people pay far less than their share of tax.

Demand for ATP in New Zealand has changed considerably over the last two decades. The 1990s saw a lot of mass-marketed ATP schemes. However, the popularity of these schemes largely ended with the introduction of the deferred deduction rule and promoter penalties in the early 2000s.

In 2001, there was a marked increase in customized ATP arrangements when the highest personal tax rate rose to 39 percent, while the corporate and trustee rates were at 33 percent. Tax agents provided a range of structures to avoid the personal services attribution rules and to exploit the progressive marginal rate system. The result was a number of self-employed people having company and trust structures set up, often with family members involved, to split income and limit exposure to the 39 percent rate.

It is envisaged that the recent flattening of the marginal tax rates is likely to reduce demand for ATP. However, there will still be arrangements designed to avoid reporting income or to produce deductions or losses for tax purposes. What we can deduce from the last 20 years or so is that taxpayers' behaviour is influenced by perceived inequities in the tax system, and the opportunity or incentive to engage in ATP activity.

Inland Revenue has recently won a number of tax avoidance cases, including some high-profile wins in the Supreme Court. This has changed the landscape markedly and the business community is now more cautious about tax planning.

2. Objective of this Research

Inland Revenue's Compliance Planning and Development Group, jointly with the ATP Portfolio (Investigations and Advice), has embarked on a strategic approach to ATP involving understanding demand and supply of ATP. This will enable Inland Revenue to adapt risk management strategies and identify successful legislative and administrative responses to ATP.

The aim of this research was to investigate the drivers behind customers' demand for ATP.

¹ We gratefully acknowledge the research fieldwork, analysis, and reporting of Litmus, an independent market research company, that conducted the in-depth interviews with tax agents and small and medium enterprises owners.

3. Methodology

A mixed method approach was used to understand ATP behaviour and attitudes among Individual and Business customers. The quantitative analysis incorporated profiling and two distinct segmentation methodologies in order to fully explore customer characteristics. In addition, qualitative interviews were conducted to provide direction for the quantitative profiling, and to gather perceptions directly from ATP customers, tax agents, and Inland Revenue staff. The compositions of the samples are shown in Table 1.

TABLE 1. Composition of Qualitative Interviews with ATP Risk Customers, Tax Agents and IR Staff

Composition of sample			
	Customers (n=22)	Tax agents (n=24)	IR staff (n=8)
Main distinguishing feature	<u>Income situation*</u> Established entrepreneurs (multiple businesses and investments) (6) Starting out entrepreneurs (multiple businesses, often change in business) (5) Long-term small businesses (professionals, tradespeople and farmers) (7) Long-term sole traders (professionals and tradespeople) (4)	<u>Business situation</u> In an accountancy firm (16) Sole trader (8)	<u>Experience in private accountancy firm prior to working at IR</u> Previously worked in an accountancy firm (7) Not previously worked in an accountancy firm (1)
Locations	Auckland (14) Wellington (4) Palmerston North (4)	Auckland (12) Wellington (6) Palmerston North (6)	Auckland (1) Wellington (3) Hamilton (3) Whangarei (1)

*All customers interviewed had complex income situations. For instance, all had investments in property and/or shares. Some (e.g., some new entrepreneurs and small business owners) were also moving in and out of paid employment as a result of fluctuations in their career and business success.

3.1 Profiling and Segmentation

The profiles of customers at risk of ATP² were compared with wider, general population profiles in order to assess the characteristics that discriminate between ATP risk and non-ATP risk customers. Population parameters were derived from a number of sources, including Inland Revenue's administrative data and Statistics New Zealand, for demographic profiles and industry classification. Customer segmentation was conducted on the data, and three clusters emerged: 'ATP-risk', 'Opportunist', and 'non-ATP risk'.

We also carried out in-depth, qualitative interviews with:

- 22 Inland Revenue customers from an 'at-risk-of-ATP sample list';
- 24 tax agents with clients on the ATP risk sample list; and
- Eight Inland Revenue staff with in-depth understanding of the relationship between customers and their tax agents.

The interviews were up to one hour in duration, and were conducted from 20 April to 14 June 2012.

3.2 Software

A package called 'poLCA', implemented in the Inland Revenue environment, was used to estimate the latent class regression model for polytomous outcome variables. The latent class regression model enables us to estimate the effects of covariates on predicting latent class membership.

For the canonical discriminant analysis, the SAS procedure, 'Proc Disc', was used to develop classification

² 'Customers at risk of ATP' in this study are 'customers who Inland Revenue suspects may be involved in ATP.' The criteria for this ATP risk group were that: (i) as a result of an initial check by Inland Revenue investigations staff, they had been identified as having indications of potential ATP risk that warranted an audit, and (ii) they had been audited by Inland Revenue sometime between 2001 and 2010, and a discrepancy was found.

criteria to assign group membership. The classification criteria in Proc Disc takes into account the prior probabilities of groups as a linear function.

3.3 Limitations

This analysis covers only two customer groups: Small and Medium Enterprises (SME) and High Wealth Individuals (HWI). Other customer groups, such as Large Enterprises and Not for Profit Organisations, are out of scope for this exercise.

This research relies on ATP risk categorisation provided by the Investigations and Advice Group and did not re-categorise the supplied ATP risk cases. As stated in the methodology, the ATP risk group in this research was based on customers '*suspected of ATP*' rather than *proven* as ATP.

4. Key Findings

This section synthesises the findings from the four data collection methods used for this project. There were three quantitative analysis methodologies to profile and segment ATP risk customers, and there were in-depth interviews with Individual and Business customers at risk of ATP, tax agents, and Inland Revenue staff. The findings cover customer demographics and discriminating characteristics related to ATP, perceptions of tax and ATP, and the relationship between tax agents and customers regarding ATP.

TABLE 2. Individual ATP Risk Customer Profile Comparison

Characteristic	Approximate Percentage of Individual Populations	
	ATP risk customers	Wider population
Male	80%	50%
Over 45 years old	90%	43%
Live in Auckland	60%	35%
Live in Palmerston North	11%	5%
Self-employed	64%	8%
Salary/wage earners	8%	82%
Professional/ technical	20%	7%
Financial/insurance service	20%	3%
Rental/hiring/real estate	19%	1%
Construction	1%	6%
Filing compliance rate ^a	50%	60%
Payment compliance rate ^a	60%	85%
Linked to a tax agent	94%	24%
In tax debt	9%	16%
Had tax debt of over \$10,000	5%	1%
Income over \$60,000	63%	10%
Paid donations	30%	11%
Paid donations under \$1,000	9%	4%
Had tax credit claims over \$1,000	68%	22%
Had median expenses over \$10,000 ^b	24%	1%
Had audit discrepancy higher than \$25,000 ^c	63%	24%
Had assessed shortfall penalties of over \$10,000 ^d	30%	5%

^aThis relates to customers' on-time filing and payment compliance between 2001 and 2010.

^bThis relates to the period from 2001 to 2010.

^cThis relates to the audited population between 2007 and 2011.

^dThis refers to the audited population between 2007 and 2011.

4.1 Profiling Individual and Business Customers at Risk of ATP

Profiles were produced for Individual and Business customers at risk of ATP and compared with profiles of the wider customer population. The following tables show the major differences in characteristics discovered for each profile.

TABLE 3. Business ATP Risk Customer Profile Comparison

Category	Approximate Percentage of Business Customers	
	ATP risk customers	Wider population
Operating for 10 to 20 years ^a	67%	29%
Operating in Auckland	60%	34%
Have been struck off	15%	3%
In liquidation	5%	< 1%
Close companies	40%	35%
Loss attributing qualifying companies (LAQCs)	28%	1%
Consolidated companies	8%	< 1%
Finance/insurance services	22%	22%
Rental/hiring/real estate	18%	1%
Professional/scientific/technical	17%	7%
Filing compliance rate ^b	66%	72%
Payment compliance rate ^b	82%	84%
Linkage to tax agent	89%	61%
Had business turnover > \$500,000	29%	3%
Had liabilities > \$500,000	34%	13%
Had tax debt > \$10,000	9%	3%
Had a median profit > \$60,000 ^c	30%	6%
Had a median profit > \$500,000 ^c	11%	<1%
Had expenses > \$250,000 ^d	32%	22%
Travel expenses claims > \$10,000	10%	4%
Audit discrepancy amount > \$100,000 ^e	48%	15%
Had assessed shortfall penalty ^f	21%	13%
Had assessed shortfall penalty > \$10,000 ^f	13%	4%

^aOrganisation commencement date is used for calculating business age.

^bCustomers' overall compliance behaviour in the period from 2001 to 2010 was used to derive filing and payment compliance.

^cMedian profit pertains to the period from 2001 to 2010.

^dThis relates to the period from 2001 to 2010.

^eThis relates to the audited population between 2007 and 2011. They were compared with ATP cases for the same period.

^fThis refers to the audited population between 2007 and 2011.

In the qualitative interviews, Inland Revenue staff had very consistent perceptions of ATP risk customers that strongly matched what was found in the above profiling. For instance, Inland Revenue staff described the ATP risk customers they had encountered as most commonly male, aged 30-55 years, high-income earners, and Auckland-based.

Further, Inland Revenue staff described Business ATP risk customers as likely to be: in industries such as property development and car dealerships; self-employed; multinational companies; starting or growing a business; changing the structure of a business; and in complex income situations (e.g., with multiple income sources and/or complex expense calculations).

4.2 Tax Agent Role

The role of tax agents in ATP has received considerable attention, as they are in a position to act either as an exploiter or an enforcer of tax law. In the quantitative analysis, we found that 94 percent of Individual ATP risk customers were linked to tax agents, and 89 percent of Business ATP risk customers were linked to tax agents.³

Interestingly, ATP risk customers with tax agents were more likely to be located in Auckland, Wellington, and Palmerston North. Fifty-four percent were in Auckland, 18 percent were in Wellington, and 10 percent were in Palmerston North, compared to 33, 10, and 6 percent respectively for the wider population. This finding is directly comparable to the finding that Individual and Business ATP risk customers are also more likely to be in Auckland, Wellington, and Palmerston North.⁴

Tax agents with clients in the ATP risk group generally had around 1 to 5 ATP risk Individual customers (amongst their total client base of perhaps 100+) and 1 to 5 ATP risk Business customers as clients.

In the qualitative interviews, ATP risk customers, tax agents, and Inland Revenue staff all talked at length about the influence of tax agents on how customers approach ATP risk. Customers expect tax agents to advise them on any risks associated with their tax affairs, including any likelihood of their tax planning actions being unacceptable to Inland Revenue. In some cases, this involves agents presenting their clients with two or three tax planning options, and the tax risks associated with each. Unfortunately, tax agents themselves sometimes find it difficult to be sure about the ‘grey areas’ of tax, and how Inland Revenue will judge different tax planning options.

“The current tax law is over the heads of most clients and also for many accountants.”
(Tax agent)

The participants’ descriptions in qualitative research of the ATP customer-tax agent relationships they had witnessed indicated there were two clear dimensions to those relationships:

1. Whether it is the customer or the agent who is the catalyst for the ATP activity; and
2. The level of equality between the customer and agent (for example, mutual trust and a free flow of information between them).

These two dimensions can be used to describe four possible types of ATP customer-tax agent relationships. The views expressed in the qualitative interviews illustrated all four of these relationship types.⁵

The four relationship types are as follows:

Type 1. Customer-prompted ATP, unequal relationship.

The customer is wanting to engage in ATP, but may not be willing to share ATP-relevant information with the agent or Inland Revenue. In addition, the relationship between customer and agent can become hostile if tax disputes with Inland Revenue arise.

“They don’t want to reveal information to the agent, won’t give the facts, not transparent.”
(Inland Revenue staff)

³ It should be noted that many of the businesses not linked to a tax agent would have internal employees who are tax professionals.

⁴ See findings for ‘Region’ in the Profiling section.

⁵ Further research would be required to confirm these suggested typologies.

Type 2. Customer-prompted ATP, equal relationship.

The ATP is prompted by the customer and the agent supplies the necessary tax expertise. The two parties work together with a mutual understanding and benefit.

*“[The customer] wanted 10 percent off the tax bill, they didn’t care how.”
(Inland Revenue staff)⁶*

Type 3. Agent-prompted ATP, unequal relationship.

In this example, the agent prompts the ATP and runs the tax planning with little input from the customer. When issues arise, the customer feels it is unfair that they are targeted by Inland Revenue as they do not believe they were fully informed about the compliance risks by their tax agent. This opinion was shared by a large proportion of the customers interviewed in this research.

*“Inland Revenue defines this as tax avoidance and thinks we should know better, but we trusted our accountant.”
(Customer)*

Type 4. Agent-prompted ATP, equal relationship.

In this relationship, the ATP risk activity is prompted by the agent as a way to gain or keep the customer as a client. The customer is aware of the tax risks, but expects the agent to steer the way and win any tax interpretation arguments with Inland Revenue.

*“Agents consider avoidance and come up with two or three commercial reasons and say ‘we should get over the line.’”
(Inland Revenue staff)*

In some cases, Inland Revenue staff believe the customer is fully aware that it’s ‘too good to be true,’ but it can be difficult to confront these customers directly as the agent often interposes himself/herself if Inland Revenue investigates the case.

4.3 Segmentation

Customer segmentation was used to find the characteristics that define ATP risk customers and non-ATP risk customers. A dataset consisting of a mixture of ATP risk customers and non-ATP risk customers was segmented into discrete customer groups that share similar characteristics. Individual and Business customers were segmented separately. Three clear clusters are visible in both the Individual customer segmentation (Figure 1), and the Business customer segmentation (Figure 2), with the Business customer segmentation being the most clearly defined. The three clusters in each case were:

- cluster 1: ‘Non-ATP risk’ customers
- cluster 2: ‘Opportunists’
- cluster 3: ‘ATP risk’ customers.

The ‘Opportunists’ cluster was so named to emphasise its similarity to the ‘ATP risk’ cluster in both segmentations.

Classification error calculations⁷ showed that the model tested was robust. For Individuals, 96 percent of ATP risk cases were correctly classified as ATP (exclusively comprised of ATP risk cases), and for Business customers 72 percent were correctly classified as ATP (see Table 4).

⁶ In this example, the Inland Revenue staff member was talking about an experience they had when working in a private tax agency as a tax agent.

⁷ Classification error rate indicates the efficiency of the model in correctly classifying cases. This is estimated by applying the model results to a new dataset that was not part of the data used in the model.

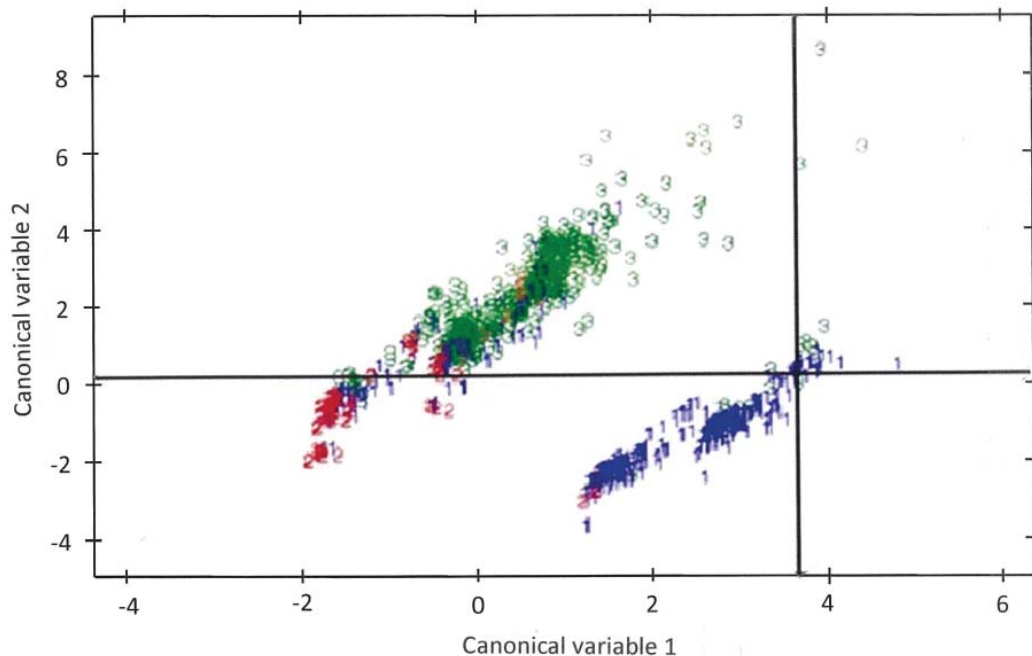
Reading Figures 1 and 2:

- Canonical variable 1: Best linear combination of independent variables.
- Canonical variable 2: Next best linear combination of variables independent of canonical variable 1.
- The horizontal and vertical lines shown in the graph help identify the optimal cut-off points in the canonical variables that separate the groups.

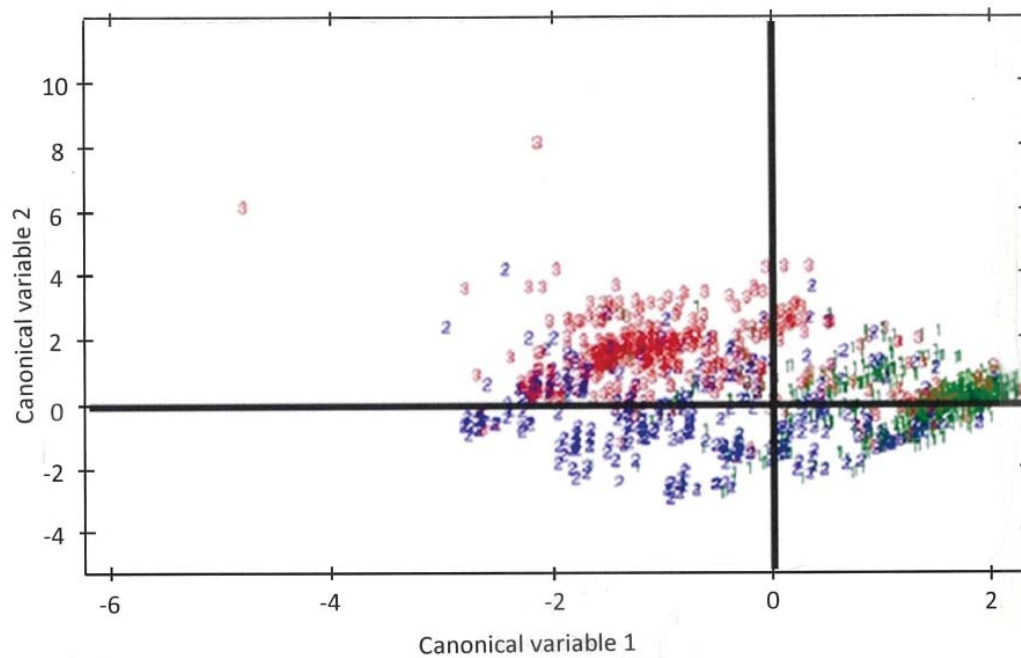
The scatter plots and the error rate calculations show that the model is efficient in predicting ATP risk and non-ATP risk cases, although as expected with this form of modelling, some cases are misclassified. This model can therefore be used to identify potential ATP risk customers from among the population as long as there is no assumption that the prediction is 100 percent accurate.

The qualitative research echoed the above quantitative segmentations as it explored perceptions of ATP. It showed that people describe a full spectrum of tax planning from universally acceptable tax planning, through to tax planning that can potentially be viewed as overly aggressive, and tax planning that most customers and tax agents would agree is unacceptable (see Figure 3).

FIGURE 1. ATP Risk Customer Segmentation—Individual Customers



Key: The codes in the graph refer to the clusters as follows; 1 is the 'Non-ATP risk' cluster, 2 is the 'Opportunist' cluster, and 3 is the 'ATP-risk' cluster.

FIGURE 2. ATP Risk Customer Segmentation—Business Customers

Key: The codes in the graph refer to the clusters as follows; 1 is the 'Non-ATP risk' cluster, 2 is the 'Opportunist' cluster, and 3 is the 'ATP-risk' cluster.

TABLE 4. Classification Rates for Individual and Business Customers

	Percentage correctly classified	
	Individual customers	Business customers
ATP (Cluster 3)	96%	72%
Opportunists (Cluster 2)	79%	77%
Non-ATP (Cluster 1)	97%	91%
Error rate	(10%)	(19%) ⁸

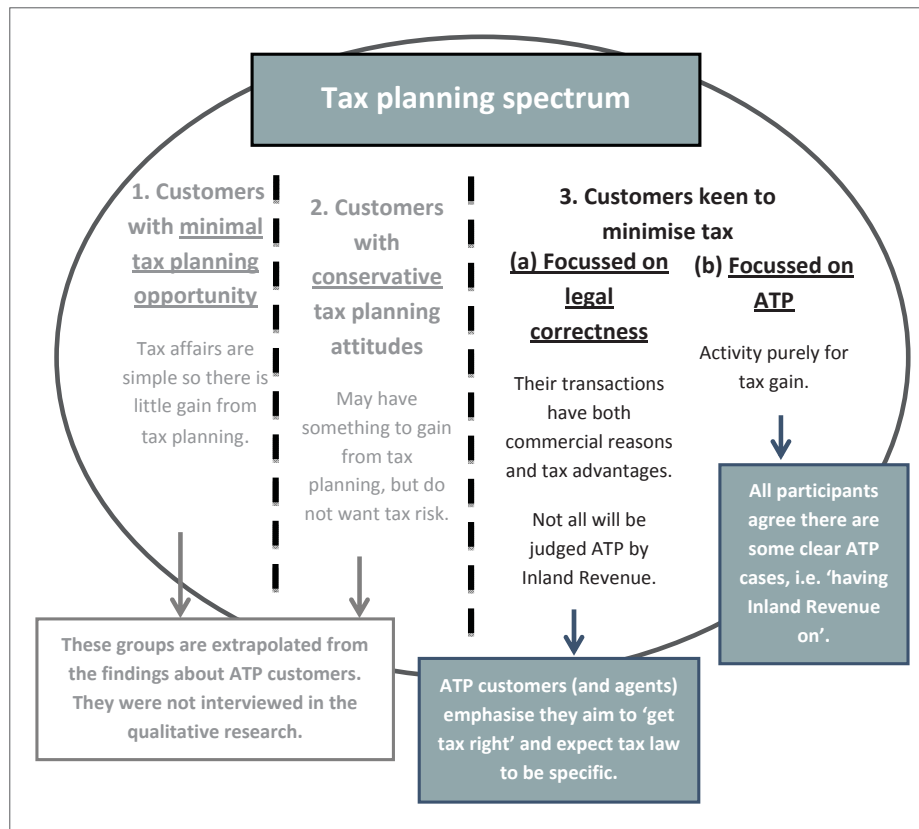
The core aspect of this qualitative categorisation is how customers decide what is 'acceptable' and 'unacceptable' tax planning. The customers and agents interviewed⁹ felt that their tax planning activity was legal and a necessary part of business success (hence part 3a of the above spectrum).

"I don't believe I should be paying more tax than I have to. I have successful businesses that pay a lot of tax. Why should I pay more?"
(Customer)

⁸ While there is more classification error for Business customers than Individual customers, the error rate of 19% is acceptable given the complexity of the data used in the analysis.

⁹ It is important to note that the customers and agents interviewed in this research were drawn from a sample of customers which Inland Revenue had identified as 'at risk of ATP,' but not proven to be engaged in ATP.

FIGURE 3. The Tax Planning Spectrum



Nevertheless, the ATP customers and tax agents interviewed also accepted that 'some people' take tax planning too far. Some participants relayed personal experiences of other people who they felt were clearly overly aggressive in their tax planning (labelled 3b in the above spectrum).

"I see wealthy acquaintances that keep making losses but continue claiming these losses against their income so they don't have to pay tax. It's a deliberate system to avoid paying tax motivated by having more money."
(Customer)

The motivations described in this spectrum may be seen as the likely motivations underpinning the three clusters (ATP, Opportunists, and non-ATP) in the segmentation graphs (Figures 1 and 2). The 'Non-ATP' cluster would align with both parts 1 and 2 of the spectrum diagram. The 'Opportunist' and 'ATP' clusters are closely placed in the segmentation, and hence are difficult to distinguish without further research. Nevertheless, these two clusters would be expected to align with parts 3a and 3b of the spectrum diagram.

4.4 Discriminators of ATP risk

Before looking at the quantitative findings for the discriminators of ATP, it is useful to first look at the qualitative findings for how ATP risk customers view tax. These show that, in general, ATP risk customers are actually fully supportive of paying tax as a social responsibility.

"It's essentially not our money, it's the government's money."
(Customer)

However, ATP risk customers (and their agents) are less agreeable to the concept of being obliged to meet the ‘intent’ of the tax law, and place far more emphasis on meeting the ‘letter’ of the law.

“Every New Zealander uses the roads, schools and hospitals and it is our obligation to promote the value of people paying their fair share, but no more, within the law.”
(Tax agent)

Further, the Inland Revenue staff interviewed stated that the most aggressive tax planners they have dealt with showed no interest even on the first aspect of ‘social responsibility to pay tax.’

“It’s a sense of entitlement. They don’t expect to pay tax on a \$10M profit, and see that as normal.”
(Inland Revenue staff)

Along with the above views of tax, it is also valuable to consider the customers’ context of operating a business. Business ATP risk customers placed a strong emphasis on growth of the business. However, some Inland Revenue staff believe that customers are sometimes led by their focus on growth into overly aggressive tax planning.

“The entrepreneurial type, they have two or three businesses that didn’t take off. They want to use those losses [for ATP] they play around with shareholding and intellectual property.”
(Inland Revenue staff)

The quantitative analysis looked for the key discriminators (or drivers) of ATP risk. The discriminators for the Individual and Business customer segmentations show certain similarities, particularly administrative compliance, the role of tax agents, and liabilities (see Table 5).

TABLE 5. Contribution of Variables into Cluster Class: Individuals and Businesses

Discriminators			
	Primary Discriminators	Secondary Discriminators	Minor Discriminators
Individual customers	<ul style="list-style-type: none"> - Administrative compliance¹⁰ - Linked to tax agents 	<ul style="list-style-type: none"> - Annual income after expenses - Individual age - Liabilities¹¹ - Professional services 	<ul style="list-style-type: none"> - Real estate and financial services - Tax credit claims - Donations paid
Business customers	<ul style="list-style-type: none"> - Administrative compliance - Business growth¹² - Linked to tax agents 	<ul style="list-style-type: none"> - Business age - Liabilities 	<ul style="list-style-type: none"> - Travel expenses claim - Auckland - Finance and insurance services - Annual turnover

The strongest discriminator of ATP risk for both Individual and Business customers is administrative compliance. Individual customers at risk of ATP have *markedly* lower administrative compliance than non-ATP risk Individual customers. Similarly, Business customers at risk of ATP have *slightly* lower administrative compliance than non-ATP risk Business customers.

Interestingly, there is a dual finding regarding administrative compliance. The quantitative analysis showed that lower administrative compliance is a discriminator of ATP risk. However, the qualitative interviews indicated that some ‘smart’ ATP risk customers maintain a high level of administrative compliance with the apparent intention of hiding their ATP activity.

¹⁰ Administrative compliance refers to on-time filing and payment of tax.

¹¹ Liabilities emerged as a secondary driver in the modelling stage but was not notable in the profiling of Individual ATP customers (i.e., 2% of Individual ATP customers had liabilities of over \$500,000, which was not clearly distinguishable from the 1.3% of the wider population who had liabilities of over \$500,000).

¹² Business growth emerged as a primary driver for Business ATP customers at the modelling stage but was not investigated at the earlier profiling stage of this study. We analysed business growth for Business ATP customers only, not for the wider Business customer population. In this calculation, growth is calculated as change in annual turnover from one year to the next and relates to the period from 2001 to 2010. For Business ATP customers: 37% had ‘low’ growth (<30% growth), 10% had ‘medium’ growth (30% to <60% growth) and 7.5% had ‘high’ growth (60% growth and above). The rest had either no growth or the information was not available.

“They do anything to avoid tax, but they do file their taxes and look like complying.”
(Inland Revenue staff)

This latter finding means that there will be some challenge in how administrative compliance can be used as an indicator of ATP risk.

The use of tax agents is another primary discriminator for both customer types, particularly so for Individual ATP risk customers. The tax agents in question were more likely to be those with higher client density (more than 100 clients).

Another result that emphasised the role of tax agents is that, for Individual ATP risk customers, 70 percent of ATP risk customers using tax agents had audit discrepancies higher than \$25,000, whereas 50 percent of ATP risk customers with no tax agents had discrepancies in that range.

For ATP risk Business customers, approximately 88 percent of those who used tax agents had audit discrepancies higher than \$25,000, whereas 63 percent of those without tax agents had discrepancies in that range.

And finally, as part of considering the discriminators of ATP, it is notable that there was a strong view that ATP activity in New Zealand has been declining in the last 10 years.

“We used to boast about how many companies we had and how many trusts, and now we boast about how few. In the past, the accountant used to structure everything so it was tax effective and I ended up with so many company structures and accountancy fees I’d have to phone the accountant to find out which company was which. People are sick of paying fees and a lot of loopholes have been shut down by Inland Revenue.”
(Customer)

This reduction in ATP activity was seen as due to people’s expectations of financial gain from ATP being greatly reduced by three environmental factors:

1. New Zealand’s reduced tax rates, plus the reduction in the gap between New Zealand’s top personal tax rate and the company tax rate;
2. Inland Revenue’s tougher approach alongside stronger ATP legislation that is more ‘generalised’ (relying less on specific examples); and
3. The global economic crisis (which has both positive and negative effects on ATP).

Regarding New Zealand’s tax rates, the general view was that lowering the rates has markedly reduced ATP activity.

“When the personal tax rate was 60 percent, everyone thought it was legalised robbery, so it became a big incentive for people to look for a way to pay less tax.”
(Customer)

Nevertheless, some Inland Revenue staff believe that some customers will maintain their ATP even when the expected gains are small.

“When the Individual’s tax rate was 39 percent, the natural tendency was to go to a Company or Trust for 33 percent.”
(Inland Revenue staff)

Regarding Inland Revenue’s tougher approach, the general view amongst Inland Revenue staff is that the implementation of penalties for the promotion of ATP was vitally important, but that an overall increase in the intensity of Inland Revenue’s approach to ATP was also effective.

“Inland Revenue is smarter now, taking it on, more aggressive, going back to things from four years ago.”
(Inland Revenue staff)

Alongside this, there is a view that, with New Zealand’s anti-avoidance tax legislation becoming more generalised in recent times, Inland Revenue has been far more successful in challenging ATP risk activity. This

shift away from having to write specific legislation for every existing and future type of ATP activity towards generalised legislation is seen as an effective deterrent of ATP.

Nevertheless, ATP risk customers and their agents, and some Inland Revenue staff, also feel that the shift has left customers vulnerable to being penalised by Inland Revenue for only 'moderate' tax planning actions.

"There has been a shift in recent case law by Inland Revenue, almost taking the view that everything is avoidance unless you can prove otherwise."
(Tax agent)

And regarding the third environmental change, the global economic crisis, some participants believe that people's appetite for business-related risk in general has been reduced.

"I'm probably more risk averse and have been since the crash in 1987. Back in those days, I thought I could walk on water."
(Customer)

Nevertheless, some Inland Revenue staff believe that there may be some customers whose appetite for ATP has been increased as a result of their financial losses.

5. Discussion

Tax planning is an important part of managing finances for Business customers and Individual customers with complex financial income or expense situations. Legislating for all the tax situations that currently exist and will exist in future is a monumental task, and needs to take into account customers and tax agents as well as the tax authority. This needs to include awareness of customers' and agents' 'honest' intentions and errors, versus 'taking advantage' of grey areas of legislation. Getting this right will serve customers and tax authorities alike as certainty is a valuable cost-saving goal for all concerned. It will also help maintain the integrity of the tax system in the view of the wider population.

5.1 Spirit of the Law

The research has highlighted that ATP risk customers generally expect their tax planning behaviour to be judged according to written tax legislation. The concept of following the 'spirit' of the tax legislation is contrary to this expectation.

It will certainly be important for Inland Revenue to continue working to make customers and tax agents aware of the need to follow the spirit of the law. One inherent difficulty will be that customers and agents will naturally ask for examples to illustrate what is meant by the spirit of the law. There may be downsides to providing such examples as they may add support to the perceived need for concrete examples in tax legislation rather than broader conceptual thinking such as 'spirit of the law.'

Nevertheless, it is pleasing to note that even ATP risk customers see value in tax authorities addressing certain ATP cases, albeit at the most extreme end of the tax planning spectrum. In fact, some participants made extremely positive statements about the importance of tax. What is different for them is that they have opportunities for tax planning that the wider population does not have, and it is unsurprising that, for them, tax can be both a social responsibility and a 'cost to be minimised.'

However, this research has indicated that some customers are in no way interested in the social responsibility of tax. There are a number of theories on compliance that state an 'illegitimate profit seeker' weighs up their expected additional earnings against their expected legal penalties when deciding how aggressive to be in their tax planning (Grasmick & Green, 1980; Kagan & Scholz, 1984, p. 69; Kirchler & Maciejovsky, 2001; Murphy, 2002). This implies that ATP risk customers are less motivated to pay tax than non-ATP risk customers. However, this requires more study.

5.2 Strong Findings for Characteristics

This research has highlighted that ATP risk customers are clearly distinguishable; along with a shadow group of customers with similar characteristics (we have called these ‘Opportunists’). The quantitative profiling of ATP risk customers produced some remarkably strong findings. The differences for Individual customers in characteristics such as gender, location, age, entity class, occupation, income and expenses are obvious, as are the differences for Business customers in characteristics such as age of business, location, entity class, nature of business, turnover and expenses. Inland Revenue staff also identified these characteristics on personal experience only.

Due to the strength of these findings about characteristics, Inland Revenue will be better able to discriminate between high and low ATP risk customers, which means better targeting and tailoring of ATP initiatives. In addition, the similarity of the ‘ATP’ and ‘Opportunist’ clusters means that there is value in targeting ‘Opportunists’ as well as ATP risk customers, as they also appear to have an elevated risk of ATP.

However, it is always worthwhile noting that there are still ATP cases that do not match the above characteristics, and there will no doubt be non-ATP cases that do match these characteristics.

5.3 Agents’ Role and ATP Demand

In this research, we were specifically looking at customer demand for ATP rather than supply from the tax agent. However, we were aware that the closeness of the agent-client relationship would make it difficult to unravel the demand and supply link, hence the inclusion of tax agent interviews in this research. As expected, the demand story centres on the nature of the agent-customer relationship. This was emphasised even further by the finding that ATP risk customers are more likely than the wider population to be linked to a tax agent.

This latter finding cannot be construed as indicating agent linkage is causal for ATP. Indeed, this research has shown that the appetite for ATP risk can just as easily come from customers as from tax agents, or it may be a combination. Many ATP studies have highlighted the risk nexus between customers and tax agents (Murphy & Byng, 2002). A key aspect of this relationship is their appetite for tax risk. Sakurai & Braithwaite (2001) discuss how customers who are open to low-risk tax minimisation strategies often find themselves with tax agents who serve taxpayers who are open to high-risk minimisation strategies.

One aspect of the customer-tax agent relationship that is problematic for any ATP initiatives is that a large number of customers put considerable onus on their tax agent to deal with their tax matters, including managing their risk relating to ATP. This means that customers will not always feel responsible for their ATP risk. Agents also will not appreciate being targeted with ATP initiatives when the responsibility for compliance does not rest with them. Therefore, any initiatives addressing ATP demand will need to focus on the decision-makers in ATP activities, and take into account the varying levels of communication, equality, and responsibility that comprise agent-client relationships.

6. Conclusion

This study increased our understanding of customer demand for ATP by (i) showing that high-and low-risk ATP customers can be identified using Inland Revenue’s administrative data, and (ii) describing their characteristics and underlying motivations regarding ATP.

6.1 Profiling ATP Customers

These results show that customers at risk of ATP can be profiled using their primary demographic and financial characteristics. Individual and Business customers at risk of ATP have separate profiles as they have some different characteristics, but there are similarities such as in the use of tax agents, nature of business and location.

ATP profiling can provide Inland Revenue with a tool for identifying future cases of customers being at risk of ATP.

Both the qualitative and quantitative elements of the research found that tax agents are a major influence on ATP risk customers. Of most concern is that agents are described as driving or prompting ATP risk activity with some customers. Further study of this interaction of 'supply and demand' for ATP is required.

6.2 Segmenting ATP Customers

The segmentation modelling approach used in this study reliably discriminated Individual and Business ATP risk customers into three latent classes: non-ATP risk customers; ATP risk customers; and Opportunists.

The segmentation had a very low classification error rate for both Individual and Business customers, showing the classification method was robust. The segmentations for the Individual customers and Business customers were both clear cut, with the Individual customer segmentation being the clearer of the two.

The qualitative interviews echoed the Individual and Business customer segmentations in that they indicated a full spectrum of views regarding what is acceptable and unacceptable tax planning. At the 'aggressive' end of the spectrum, there appears to be a small number of customers with very combative ATP attitudes. The majority of the ATP customers appear to have more moderate views of ATP, but are keen to 'not pay more tax than they need to'.

The segmentation showed that about 10 percent of Individual and 20 percent of Business customers at risk of ATP did not depend on an agent. This requires further investigation as this indicates a group of customers with a unique form of ATP risk.

Having a reliable basis for identifying customers at risk of ATP means Inland Revenue will be able to better target its ATP-related audits and other interventions.

6.3 ATP Drivers

This research has shown that, even though ATP risk customers and tax agents agree with the necessity of tax, they strive to minimise tax as far as legally possible. The overall impression is that customers at risk of ATP are generally inclined towards low-end ATP behaviour, but they may fluctuate between 'acceptable' and 'aggressive' tax planning. Hence, ATP risk customers are illustrating precisely the concept of ATP in that they are concentrating on the 'letter of the law but not the intent'.

The quantitative analysis of Inland Revenue's data on ATP risk customers has shown that there are both similarities and contrasts in the ATP drivers for Individual and Business ATP risk customers. Both are heavy users of tax agents and yet both have lower administrative compliance which seems surprising as agent use is normally associated with higher compliance. Both groups have pronounced financial activity with their high income/turnover and liabilities.

What is interesting about Individual ATP risk customers is that they stand out from the wider population of Individual customers with their notably higher use of agents, being 'professionals,' and their specific use of travel expense claims, tax credit claims, and donations.

Business ATP risk customers, on the other hand, are harder to distinguish from the wider Business customer population. Their administrative compliance and use of tax agents are only slightly different to those of the wider Business customer population.

The data and the characteristics used in this research are limited and the outcome of this study can be used as a guideline for future research to explore the behaviour of ATP risk customers more closely. For example, tax research literature has identified that Effective Tax Rate (ETR) has an important role in identifying ATP risk from non-ATP risk customers. Any future work should focus on this factor more closely to come up with a pragmatic solution.

Some positives can be seen in the overall environment surrounding ATP risk activity. In the last 10-12 years, New Zealand has seen business and personal tax rates reduced, stronger tax legislation, a tougher ap-

proach from Inland Revenue, and a reduced appetite for risk due to the global economic crisis. However, ATP risk activity has not ceased, and Inland Revenue has a long way to go to move ATP risk customers and agents from concentrating on legal specifics to concentrating on the overall intent of the tax legislation.

Further work needs to be done on a sample of customers who are actually known to be involved at different levels of ATP schemes including high-, medium- and low-risk scenarios.

Finally, much is still needed to be done to understand the complex nexus existing between ATP risk customers and tax agents.

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